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# Do financial advisors have consumers' best interests? Not always, but trust is key, say experts

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In a world of volatile markets and complex financial products, getting financial advice from professional financial planners and advisers might seem like a good idea for those trying to meet their financial goals. However, finding good, impartial and suitable advice might be akin to finding a needle in the proverbial haystack.

In 2011, the Monetary Authority of Singapore (MAS) conducted a mystery shopping exercise to assess the types of products that were being recommended to consumers. The findings were disheartening - it was found that some 30 per cent of the products recommended were ill-suited to the needs of consumers.

Recommendations did not necessarily suit the time horizon, investment objectives or risk tolerance of the clients. In fact, half of the advisers in the survey said they did not ask their clients about their financial objectives or risk tolerance, and 40 per cent did not even enquire about their clients' past investment experiences.

"If we do not make an effort to understand our clients' needs, how do we expect to recommend the right product to them?" asked Lee Chuan Teck, MAS' assistant managing director, at the Market for Financial Advice conference organised by Singapore Management University's (SMU) [Centre for Silver Security](#).

Lee went on to state that a financial adviser's main responsibility is to provide clients with basic financial planning skills, and to help them understand investment products. "Why do we need financial advisers? Contrary to popular belief, it is not to sell financial products. If it's just to sell products, there are far more efficient ways," he opined.

Rather, financial advisers should be like teachers. They should coach their clients on how to draw up a savings plan, build an investment portfolio and understand what kinds of insurance will be needed. They should provide expertise, customising information to their clients' needs and guide them in putting these practices in place.

Lee said: "In (Singapore's) disclosure-based regime, the issuer or distributor of a financial product has the obligation to disclose all critical information about the product, but the onus is on the investor to understand this information, place these in the context of the investment environment and then arrive at a judgement on whether this is suitable for them or not."

"The reality, however, is that investors have different starting points, degrees of financial knowledge and experience, and thus will likely have different capacities to process the information disclosed. Professional financial advice fills in the knowledge gap for the less knowledgeable investors," added Lee.

### **What motivates financial advisers?**

One reason why financial advisers may not always guide the client to make the best decision is because the financial advisory industry has its own interests, which are different from the clients' interests, said John A Turner, director of US' Pension Policy Centre.

A common source of this conflict of interest is the way in which fees are charged. Fees may be levied as a percentage of assets under management, commissions, an hourly rate, or are performance-based, and payments from third parties such as mutual funds or brokers are not uncommon.

Commissioned-based fees explain why advisers are often biased towards recommending actively managed funds, even with their higher expenses and trading costs when compared to low-cost, passively managed funds. As an example of how advisers act on self interests,

Turner referred to a study that found advisers who recommended actively managed funds with high fees to clients already established in low cost, well-diversified, index funds.

Such problems are compounded by the fact that the industry is rife with jargon and terminology that makes it quite difficult for individual customers to understand clearly what they are paying for. This confusion benefits financial advisers as it allows them to charge higher fees, said Turner. Advisers may not always be impartial enough to act on their clients' best interests over and above self-interests.

Even financial advisers compensated from assets under management are not free from such conflicts of interests. These advisers might, for example, advise clients to avoid paying down a mortgage because doing so will reduce the asset base on which their fees are computed. Turner's take: charging by the hour or at a flat rate per project will more likely reduce such conflicts of interest. Goethe University's professor of finance Andreas Hackethal suggested that the goal of financial advisory should not be to outperform the markets but to help clients manage their risks and to achieve performance that aligns with their risk profile. This is supported by a 2011 government study that surveyed 600 investors, of which 55 per cent said they expected their advisers to manage both risks and returns.

To facilitate comparisons across the industry, Hackethal proposed a simple report where a one-year performance is defined by two parameters only. The first is the risk level that the client is planning to bear, in comparison with the risk actually borne, expressed in terms of variation in portfolio value. The second is the actual performance of the portfolio versus how portfolios of other investors from the same risk category performed.

This standardised analysis, if made compulsory, should enhance transparency and reward those financial advisers that provide good advice. But Hackethal cautioned: It is not only the financial adviser's fault when results are bad. Clients also need to provide clear and accurate information. "This requires trust, ex-ante."